

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

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| Great Northern Utilities, Inc. |) | |
| |) | |
| Camelot Utilities, Inc. |) | |
| |) | |
| Lake Holiday Utility Corp. |) | Docket Nos. 11-0059 |
| |) | 11-0141 |
| |) | 11-0142 |
| Proposed Increase in Water and |) | (cons.) |
| Sewer Rates |) | |
| |) | |

INITIAL BRIEF OF
THE PEOPLE OF THE STATE OF ILLINOIS

The People of the State of Illinois

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The People of the State of Illinois, by LISA MADIGAN, Attorney General of the State of Illinois (the “People,” or “AG”), pursuant to the Commission’s rules, 83 Ill. Admin. Code 200.800, file their Initial Brief in opposition to Utilities, Inc.’s (the “Company”) request for an increase in revenues from its water and sewer customers in Illinois.

I. STATEMENT OF FACTS

This consolidated docket involves the request of three Utilities, all of which are wholly owned by the Company, to increase the rates for water and/or sewer service provided to Illinois residents. The Utilities whose rates are at issue are: (1) Great Northern Utilities, Inc. (“Great Northern”); (2) Lake Holiday Utilities Corp. (“Lake Holiday”); (3) Camelot Utilities Inc., Water Service (“Camelot Water”); and (4) Camelot Utilities Inc., Sewer Service (“Camelot Sewer”). See, *e.g.*, Great Northern Ex. 1.0 at 1.¹ The Utilities all use the same central management company, Water Service Corporation, another wholly owned subsidiary of the Company, to perform all of their administrative tasks such as accounting, administration, billing, and other tasks. *Id.* at 1-2.

The Utilities are small, both in the number of customers they serve and in the size of the areas they cover. Great Northern operates in Winnebago County, Illinois, and serves approximately 360 customers. GNUI Ex. 1.0 at 2. Camelot provides water and wastewater services to approximately 200 customers in Joliet, Shorewood, and Channahon, Illinois. CUI Ex. 1.0 at 2. Lake Holiday provides water service to approximately 2,000 customers in LaSalle County. LHUC Ex. 1.0 at 2.

¹ Lena Georgiev’s testimony was adopted by Steven Lubertozi, who testified on behalf of all three companies: Great Northern, Lake Holiday, and Camelot. The direct testimony repeats much of the same information for all three Utilities.

Despite being organized to realize economies of scale and permitted to function as a monopoly, the Utilities' financial performance since 2006 has varied greatly in the amount of net income that they have received or lost. Table 1, below, shows the amount of net income or net loss reported by each Utility to the Commission in their Annual Reports (ICC Form 22). This table covers the time from the year ending December 31, 2006 through the year ending December 31, 2009. It also shows the *pro forma* net income prior to any rate or revenue increase which would result from the Joint Stipulation between the Staff of the Illinois Commerce Commission ("Staff") and the Company.

Table 1. Net Incomes/Losses for 2006 Through 2009 and Pro-Forma Net Income.

| <u>Name of Utility</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>Pro-Forma Net Income</u> |
|------------------------|-------------|-------------|-------------|-------------|---------------------------------|
| Great Northern | \$(8,680) | \$(49,308) | \$(23,671) | \$(36,294) | \$(32,574) |
| Lake Holiday | \$54,628 | \$(11,637) | \$(107,882) | \$(49,695) | \$(2,584) |
| Camelot, Comb. Serv. | \$(34,703) | \$9,508 | \$28,408 | \$(31,333) | \$(26,788) |

Sources: AG Cross Ex.6; Table 1 on page 3, supra.

The cause of this substantial, apparently random fluctuation in the Utilities' net incomes from year to year was never fully explained by the Company, aside from citing unidentified "rising costs" and the implementation of a computer system (Project Phoenix) as factors. GN Ex. 1.0 at 2, 4. The Company also could not identify whether any Utility realized net gains or losses, or the extent to which any may have realized net gains or losses, for any year prior to 2006. Tr. at 119, July 13, 2011.

These wide variations in net income, including regular and substantial reported losses, did not prevent the Company from making large capital investments. Table 2, below, shows the amount of capital improvements identified by each utility in response to AG data requests asking

for the completion year and amount of each capital improvement for each year.² Table 3 shows the investments the Utilities actually identified in response to AG data requests.

Table 2. Gross Plant in Service and Rate Bases for Years 2000 and 2009

| <u>Utility</u> | <u>Gross Plant in Service Year 2000</u> | <u>Gross Plant in Service Year 2009</u> | <u>Rate Base Year 2000</u> | <u>Rate Base Year 2009</u> | <u>Joint Stipulation</u> |
|----------------|---|---|--------------------------------|--------------------------------|------------------------------|
| Great Northern | \$ 532,237 | \$ 1,806,527 | \$ 190,356 | \$ 1,365,821 | \$ 1,363,881 |
| Camelot | \$ 1,195,556 | \$ 2,128,877 | \$ 588,213 | \$ 1,350,421 | \$ 1,630,362 |

Sources: AG Cross Ex. 5; AG Cross Ex. 6.

Table 3. Amount of Capital Improvements by Year Identified In Data Request Responses.

| <u>Utility</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> |
|----------------------|-------------|-------------|-------------|-------------|
| Great Northern | \$32,273 | \$0 | \$84,065 | \$820,255 |
| Lake Holiday | \$19,946 | \$0 | \$7,416 | \$58,875 |
| Camelot, Comb. Serv. | \$186,017 | \$0 | \$138,271 | \$0 |

Sources: AG Cross Ex. 1; AG Cross Ex. 2; AG Cross Ex. 3

Staff and the Company stipulated that the appropriate rate of return for each of the Utilities is 7.71%. Staff-Company Joint Exhibit 1.0 Revised. Staff derived this rate by employing a discounted cash flow model and a risk premium model, under the assumption that comparable water utility and public utility samples would accurately represent the risks and cash flows of the Company. Staff Ex. 3.0 at 8. Notably, Staff did not consider the magnitude of the increase requested, the impact of the increase on customers, the quality of water provided by the utilities, or any measure of customer satisfaction. Tr. at 164-168, July 13, 2011.

² These figures are the sums of the *itemized* capital investment. The Company claims that it has invested substantially more in capital improvements than it itemized.

Table 3, on the next page, identifies the revenue requirement increases sought by the utilities based on the revised Joint Stipulation offered by the utilities and the Staff. These revenue requirements are the result of a standard ratemaking formula: Revenue Requirement = (Operating Costs) + (Rate Base)*(Rate of Return). *Citizens Util. Co. v. Ill. Commerce Comm’n*, 124 Ill. 2d 195, 200-01, 585 N.E.2d 510, 512-13, 124 Ill. Dec. 529 (Ill. 1988). These numbers incorporate the corrections to the “allocation” adjustment identified at the hearing.³

Table 4. Current Pro-Forma Revenues and Proposed Revenue Requirements.

| <u>Name of Subsidiary</u> | <u>Pro-Forma Revenues for Test Year</u> | <u>Proposed Revenue Requirement</u> | <u>Percent Increase</u> |
|--|---|---|-------------------------|
| Great Northern | \$91,881 | \$322,249 | 251.72% |
| Lake Holiday | \$465,098 | \$658,616 | 45.60% |
| Camelot - Water | \$86,424 | \$238,377 | 175.82% |
| Camelot - Sewer | \$117,025 | \$201,134 | 71.87% |
| [Note: With all else held equal, a 100% increase would reflect an approximate “doubling” of the customers’ current rates.] | | | |

Sources: ICC Staff Ex. 10.0; Schedules GM 10.01 and LH, C-S, C-W 10.01 Rev.

In response to the size of the revenue increases requested by the Utilities and largely incorporated into the Staff rebuttal testimony, the People offered the rebuttal testimony of Roger Colton. Colton is a national expert on the effect of utility rates on consumers and more generally on the issue of affordability. AG Ex. 1.0 at 1 & App. A. He compared the Utilities’ initial proposed rates (which are somewhat higher than those in the Revised Joint Stipulation) to both a 2010 survey of water and sewer rates prepared by the City of Carbondale (256 jurisdictions across Illinois), and the ICC’s 2010 report of water and sewer systems with fewer than 1,000

³ In their Rebuttal Testimony, the Staff recommended revenue requirements for each utility that was greater than the revenue requirements recommended in Staff’s direct testimony. However, the revenue requirements were reduced when an error identified by the People was corrected. Tr. at 254 (July 14, 2011)

customers. AG Ex. 1.0 at 7-8. Table 4, on the next page, compares Colton’s findings to the rate increases sought by the Company based on the Revised Joint Stipulation.

Table 4. Comparison of Carbondale Survey, ICC Report to Companies’ Rates.

| | <i>Average Water Rates (assumed usage of 6,000 gallons per month)</i> |
|--|---|
| Average Monthly Water Bill (Carbondale Survey) | \$ 34.23 |
| Average Monthly Water Bill (ICC Report) | \$ 36.90 |
| Highest Monthly Water Bill (Carbondale Survey) | \$ 70.70 |
| Highest Monthly Water Bill (ICC Report) | \$ 80.29 |
| Lake Holiday | \$ 33.57^a |
| Great Northern | \$ 82.41^b |
| Camelot, Water | \$ 101.52^c |
| | <i>Fixed Sewer Charges</i> |
| Average Monthly Sewer Bill (Carbondale Survey) | \$ 23.61 |
| Average Monthly Sewer Bill (ICC Report) | \$ 34.44 |
| Highest Monthly Sewer Bill (Carbondale Survey) | \$ 82.62 |
| Highest Monthly Sewer Bill (ICC Report) | \$ 73.75 |
| Camelot, Sewer | \$ 76.85 |

^a \$33.57 = fixed charge of \$5.19 plus a usage charge of \$4.73 per 1,000 gallons.

^b \$82.41 = fixed charge of \$26.07 plus a usage charge of \$9.39 per 1,000 gallons.

^c \$101.52 = fixed charge of \$14.64 plus a usage charge of \$14.48 per 1,000 gallons.

Sources: AG Ex. 1.0; GN Ex. 5.0 at 1; LH Ex. 5.0 Rev. at 1; C-W Ex. 5.0 Rev. at 1; C-S Ex. 5.0 Rev. at 1.

Colton further testified that ratemaking involves a balancing of investor and ratepayer interests, and that the avoidance of “rate shock” is a settled doctrine in ratemaking. AG Ex. 1.0 at 6; *see also Ill. Bell Tel. Co. v. Ill. Commerce Comm’n*, 414 Ill. 275, 287, 111 N.E.2d 329, 336 (Ill. 1953) (quoting the Supreme Court in *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944)). Colton concluded that “given the ratepayer interests [discussed in] my testimony, the Commission would be more than justified to set the return on equity toward the bottom of an acceptable range.” AG Ex. 1.0 at 6. The ratepayer “interests” identified by Colton

have been an underlying theme in the comments voiced by the utilities' customers. In response to Great Northern's proposed increase, one customer stated:

I feel that a small increase would be acceptable (very small) in order for us to know that the water that we are drinking is safe. Please reconsider and think of people like myself and many more that I know of that are on fixed incomes. Also, we have not gotten increases in our social security benefits for 2 years and now they are saying that we will have to go another year without an increase! WHAT ARE WE TO DO!!!! I have worked for over 25 years, most of them working 2 jobs just to keep a roof over my families heads.

Anne Bukowski, public comment filed under Docket No. 11-0059.

Another Great Northern customer stated, "Many people have nothing we can spare. People, everyday, are already having to make hard choices between medical costs and food, gas in the car or heating and cooling of their homes." Ken Coonley, comment filed under Docket No. 11-0059.

Similar sentiments were expressed by consumers in the Camelot service area. Camelot consumer Cheri Wan Eck filed a comment: "My husband has been out of work for quite a while and I know ours is not the only family struggling." (Cheri Van Eck, public comment filed under Docket No. 11-0141, April 8, 2011). Suzanne Basak, Treasurer of the Camelot Homeowners' Association, described the disparate situation facing many homeowners in the association: "We have homeowner's dues of forty-five dollars annually and usually face the fact that at least one fourth of our homeowners are unable to afford these meager dues. We have many homes in our neighborhood that are in foreclosure and many homeowners that have been unemployed over the last few years of this fiscal crisis." Suzanne Basak, public comment filed under Docket No. 11-0141, March 14, 2011. These customers' comments indicate that they can hardly afford their

costs of living at the current utility rates, and that a rate increase of this magnitude will be very burdensome.

In response to Colton's testimony and consumers' objections to the increases, one of the Company's witnesses, its Executive Director of Regulatory Accounting, Lubertozzi, pointed out that the Utilities have not increased their rates since 1993 (Camelot and Lake Holiday) and 1998 (Great Northern). GNUI Ex. 1.0 at 2; LHUC Ex. 1.0 at 2; CUI Ex. 1.0 at 2. Another of the Company's witnesses, its Regional Director of Operations, Haas, suggested that consumers have benefitted from this long hiatus, and therefore the Commission should not be concerned about the tremendous magnitude of the requested increases. GNUI Ex. 4.0 at 4-5.

II. ARGUMENT - INTRODUCTION

This Commission should reject the Company's proposed rate increases for each Utility. In making its order, the Commission must make an independent finding to support its order because not all intervenors are parties to the Revised Joint Stipulation. With this in mind, the evidence presented to this Commission supports an order rejecting and greatly reducing the proposed rate increases.

First, the Utilities and the Company as a whole has been managed in a substandard manner. The variability in the Utilities' net income and losses over the last several years calls into question the prudence of the Utilities' decision to increase rate base by hundreds of thousands of dollars while operating at a purported loss. The Commission must question why the Company permitted the Utilities to obtain capital when they charged consumers substantially less than their operating costs and produced *no return on investment* for so many years. Also missing is any explanation or evidence justifying substantial portions of the Utilities' claimed capital investments. In this respect, the Utilities have not met their burden to prove their costs,

and these costs should not become the basis for increased rates. Consumers have the right to know what is driving these tremendous rate increases, yet the Utilities have not presented evidence about what most of the investments were or why they were needed.

Additionally, while the Company has admitted that economies of scale associated with utility service create savings for customers, the Company operates a highly fractured structure, resulting in very high rates for the smallest systems, such as Camelot and Great Northern. Operating expenses alone, excluding the cost of plant, equal a monthly cost of \$19.17 for Lake Holiday with 2,000 customers, \$28.81 for Great Northern with 360 customers, and \$39.73 for Camelot water customers.⁴ The operating costs for these small systems combined with major investments claimed by the Utilities, that have not been adequately described or justified, would result in Camelot and Great Northern customers paying the highest rates in the state according to both the Carbondale and the ICC rate surveys. The Commission should only allow the Utilities to increase rates for costs and investments that were clearly explained and justified.

Second, the return on equity to which the Company and the Staff stipulated for the Utilities is too high and should be reduced to protect consumers both by reducing the magnitude of the requested increase and to reduce the profit the Utilities produce due to the poor management that resulted in the rate spikes requested in this docket. In addition, the poor quality of service being provided in the Camelot service area should result in a decrease in the reasonable profit level (return on equity) for that Utility. The Utilities provide an essential, but monopoly service, and the Commission provides the sole check on their pricing and performance. This Commission should reduce the rates proposed specifically for Camelot.

⁴ Total operating expenses from Staff Ex. 10.0, Sch. 10.01 and 10.01 revised, column d, line 20, divided by the number of customers and the number of months.

Third, this Commission should conclude that the proposed revenues and rates would constitute rate shock and are unfair to consumers. The regulatory compact is premised on the utility managing its operations to incorporate the concepts of gradualism and rate continuity so that rates are predictable, just, and reasonable. Until the filing of the tariffs in this case, the customers had no reason to expect that their rates would be increased or that increases of the magnitude requested were possible, and now they are facing the immediate implementation of extraordinary increases. These increases place an unexpected and substantial burden on customers. Yet, the customers cannot avoid this burden because the water and wastewater services are provided by local monopolies and are essential services without which residences are uninhabitable. The Utilities have breached a promise made to the customers to gradually seek predictable, just, and reasonable rates, and in doing so, are seeking to implement rates *suddenly exceeding the highest rates in the state*. Customers depend on this Commission to protect their interests along with the interests of the Company's shareholders, and for this reason, these rates should be rejected by this Commission.

A. The Commission Is Not Bound By the Joint Stipulation Between The Utilities and Staff Because It Is Not Unanimous Among All Intervenors.

At the hearing, the Company and the Staff offered a Joint Stipulation containing the revenue requirement described on page 3, *supra*. Illinois law is clear that when fewer than all intervenors are parties to a stipulation or "settlement" the Commission must "make an independent finding, supported by substantial evidence in the record as a whole, that the proposal would establish just and reasonable rates" in order to accept the terms of the Stipulation. *Business and Professional People in the Public Interest v. Illinois Commerce Commission*, 136 Ill.2d 192, 217 (1989). The Joint Stipulation was not agreed to by the People or by the Camelot Homeowners Association, both intervenors. Because not all intervenors have agreed to the Joint

Stipulation, the agreement is only a partial settlement. This Commission must make an independent finding, supported by the evidence in the record, to justify its order.

As will be shown below, the evidence in the record demonstrates that the revenue increases sought by the Utilities are too large and sudden to be reasonable and prudent, that the increases in rate base were not explained or justified, and that the huge increases should be rejected because they are not justified by the record and would result in rate shock.

B. The Proposed Rates Should Be Rejected Because The Utilities Failed To Justify The Huge Increases In Rate Base They Seek To Include In Rates, And Their Management Has Been Imprudent And Unreasonably Costly To The Customers.

This Commission should be alarmed at the way in which the Utilities and the Company as a whole has conducted their business. The Illinois Supreme Court has recognized that unjustified, unexplained expenses should not be included in the rate making formula. *See Peoples Gas Light & Coke v. Slattery*, 373 Ill. 31, 66, 25 N.E.2d 482, 499 (Ill. 1940). The Utilities have incurred substantial costs in capital investments and rate base, despite realizing net losses and uneven revenues since at least 2006. Additionally, this Commission should find that the expenses that the utilities have incurred as a result of their imprudent and unfair management decisions cannot be included as part of rates which they propose to charge to customers.

1. The capital expenditures were imprudently incurred during a period of operating losses, and a large portion of the claimed expenditures are not supported by any evidence in the record.

The evidence in the record shows that the Utilities have elected to undergo expensive capital improvement projects despite purportedly operating at a loss. Table 2 on page 4, *supra*, shows net incomes from fiscal year 2006 to fiscal year 2009, while Tables 3 and 4, on page 4, *supra*, show the increase in gross plant in service and rate base from 2000 to the 2009 test year

and the amounts of money that the actually Company identified as capital improvements during the same years, respectively.

Despite the fact that Great Northern was losing substantial sums of money every year beginning in 2006 (if not before) and Camelot lost money for several years beginning in 2006, the Company elected to undergo various, expensive capital improvement projects in those areas. For example, in 2009, Great Northern, having netted a loss of \$36,294 in income, committed \$768,748 towards purchasing “ion exchange equipment.” When given the opportunity to describe for the record whether there was anything “special,” or “different,” about this investment, the only response given by the Company was, “well, it's certainly one of the largest capital expenditures that we had to make.” (Tr. at 30, July 13, 2011). In a competitive market, this decision would have been critically examined, perhaps some type of cost-benefit analysis performed, and consumers would have gone elsewhere if faced with prices that increased more than 200%.

But, this is not a competitive market. These types of capital projects have the effect of driving up rates while providing a profit to investors. Given the tremendous effect these investments have on rates, the Utilities have an obligation to explain what these investments are for. Instead, the information the Utilities provided for Great Northern and Camelot was not provided in the Utilities direct case as an explanation for the extraordinary increases requested, but only in response to a data request. (AG Cross Ex. 1-5.) This Commission should find that Great Northern and Camelot have not justified increasing rate base by anything more than the amounts shown in Table 3 above, and adjust rate base to remove the remainder of its claimed investment. When a company is hemorrhaging money, as were the Utilities for the past few years, it is neither prudent nor reasonable to incur such extensive capital costs. A slower pace of

investment would have been a prudent approach to insufficient revenues and would have allowed the Commission to review the increases in rate base for prudence and reasonableness before the cost of these investments drove rates higher than any other rates in the state.

The Company has not met its burden to show how the rate base has increased to the sums that the Company and Staff agree to in the Revised Joint Stipulation. The burden of proof to establish the justness and reasonableness of the proposed rates is on the utility. 220 ILCS 5/9-201(c) (2011). In the Company's testimony, it simply asserts that the Utilities' rate bases increase by \$1.3 million (Great Northern), \$1.3 (Camelot), and \$1.8 million (Lake Holiday), and offer no explanation or itemization of the investments. (GNUI Ex. 2.0 at 5; CUI Ex. 2.0 at 5; LHUC Ex. 2.0 at 5).

In response to AG data requests asking the utilities to "identify the year of completion and the amount expended for each capital improvement identified in the Direct Testimony of Bruce Haas," the Company only identifies a small portion of the additional rate base claimed. Great Northern itemized \$936,593 out of claim \$1.3 million. (AG Cross Ex. 1; Tr. at 25, July 13, 2011). Camelot itemized \$538,956 out of claimed \$1.3 million (AG Cross Ex. 2; CUI Ex. 2.0 at 5; Tr. at 31, July 13, 2011). For Lake Holiday, Hass testified to \$1.8 million in total plant additions but itemized only \$192,949. (Tr. at 34, July 13, 2011; AG Cross Ex. 3). The Company has not introduced any evidence into the record to explain these differences. It has not met its burden to show why the \$1.3 million (Great Northern), \$1.3 million (Camelot), and \$1.8 million (Lake Holiday) are reasonable.

The record lacks sufficient justification for the increase in rate base requested by the Utilities. The need for reliable justification is heightened when the increases requested are so large and so much time has passed since the last time the Utilities submitted to rate review. The

Commission should only allow the Utilities to increase their rate base by the amounts identified in AG Cross Exhibits 1, 2 and 3. Indeed, without these cross exhibits, the record would be devoid of any explanation for the huge increase in rate base, revenues and rates requested from the public. The People request that the Commission adjust the rate base for Great Northern and Camelot (combined water and sewer) to reflect no more investment than the amounts identified in AG Cross Exhibits 1 and 2.

2. The allowed return on equity should be reduced to reflect the utilities' poor management and to protect consumers from rate shock.

In assessing an allowed return on equity, Staff witness Freetly did not take into account the size of the rate increase, service quality, or other management issues. Tr. at 164-168, July 13, 2011. The Commission should reduce an otherwise appropriate rate of return both to protect consumers and to impose the discipline that a competitive market would impose.

When there are competitors for a non-essential service, prices are constrained because customers are free to decline to take service from a high priced provider, or avoid the service altogether if the price becomes unacceptably high. The Commission and utility regulation in general are designed to protect consumers from the abuses that can arise when there is a single provider of an essential service like water. The rate increases requested for Great Northern and Camelot require the Commission to exercise its power to limit rate increases to just and reasonable levels. As the consumer comments and testimony have made clear, consumers do not find increases of the magnitude requested in this docket reasonable. Further, AG witness Colton makes clear that such increases, to the highest rates in the state, are not affordable. AG Ex. 1.0 at 19-26.

The People recommend that the rate base contained in the Joint Stipulation be reduced to the investments actually described by the Utilities in the record (see Tables 2 and 3 above). Further, the People recommend that the return on equity be reduced by 100 basis points to protect consumers from paying an overly generous profit to a company that has failed to manage its operations to control its costs and the increases expected of the public. This results in a return on equity of 8.56% and an overall rate of return of 7.26%.

The Joint Stipulation contains an overall rate of return of 7.71%, which incorporates a return on equity of 9.56%. Staff Ex. 3.00, Sch. 3.01. The 9.56% return on equity is derived from several analyses, including a DCF analysis of energy utilities. *Id.* at Sch. 3.7. It is noteworthy that the Staff DCF analysis for water utilities produced a return on equity of 8.59%, which is only 3 basis points higher than the People recommend in this docket. *Id.* Staff witness Freetly's analysis shows that water utilities' returns were as low as 7.22%, and that four of the seven sample companies had return on equity of less than 8.0%. An 8.56% ROE for the Utilities is reasonable and is supported by the record. It is also necessary to protect consumers from paying excessive profits to a utility that has failed to control costs and honor the regulatory compact.

3. The structure of the Company increases the costs which it passes on to its customers; costs which are unjustified, imprudent, and unreasonable should be removed from rates.

While the Company recognizes that economies of scale can be realized when utility companies consolidate to form larger markets, the Utilities' rates do not reflect any benefit from such economies. The Company has made inconsistent statements regarding the economies of

scale that occur in the water and sewer utility industry. Colton compared the Company's proposed rates to water and waste water rates paid to both privately operated and publicly operated utilities throughout Illinois. AG Ex. 1.0 at 5-6. In a rebuttal to the comparison to public utilities, Haas, a Regional Director of Operations for the Company, recognized that "economies of scale associated with the location of business and thousands of households within [a neighboring market not served by Utilities, Inc.] allow [the Utility] to have lower rates by spreading the fixed costs of the utility system over a large customer base." CUI Ex. 4.0 at 4. But, in an apparent contradiction to Hass' statement, Lubertozi admits, "[The Company focuses] on the purchase, formation and expansion of smaller water and/or sewer utility systems. At the present time [the Company] has over *70 systems . . . in 15 states.*" See e.g., GNUI Ex. 1.0 at 2 (emphasis added).

The Company recognizes that economies of scale develop as utility providers are able to consolidate large numbers of customers into bigger markets, yet, the Company maintains a fractured structure across many tiny systems. The inconsistencies between the Company's operational structure and what the Company asserts is a cost-saving structure show that the Company is unjustifiably incurring costs which it is passing onto the Utilities' consumers. This Commission should reject the unjustified proposed rates.

In addition, a large portion of the Utilities' expenses are allocated from the Water Services Company, where economies of scale should be realized. Yet, in response to a Staff data request, the Utilities *increased* the costs allocated to Camelot water and sewer and to Lake Holiday, driving *up* expenses, rather than decreasing them. See Staff Ex. 2.0, Sch. 2.01 C-S, 2.01 C-W. The Joint Stipulation includes these increased allocations, which raised expenses in these areas despite Staff witness Bridal's testimony that (1) the Utilities did not allocate costs

consistently with the method of allocation described by them and (2) the Company should “provide in direct testimony in future rate cases a detailed explanation of how Utility and WSC salaries are determined in total, allocated to the individual Utility, and directly charged to rate case expense and other “cap time” categories, accordingly.” Staff Ex. 11.0 at 4 and 6. The Commission should reverse this Staff adjustment and reduce the allocations for operating expenses in light of the Utilities’ failure to adequately explain the basis for the allocations.

C. The Proposed Rates For The Camelot Service Area Should Be Rejected Because The Company’s Investors Would Be Earning An Unjustifiably High Return On Their Investment At The Customers’ Expense.

The rate of return that Camelot’s investors are receiving is not appropriate considering the product which is being provided. As one customer put it, “Providing a service that is already poor at best and then asking for a rate increase of such magnitude [sic] is beyond what residents can bear.” Dianne Simo-Peon, public comment filed under Docket No. 11-0141, March 23, 2011. A balance must be maintained between the rates charged by utilities and services performed. *Citizens Utils. Co. of Ill. v. O’Connor*, 121 Ill. App. 3d 533, 540, 459 N.E.2d 682, 688, 76 Ill. Dec. 767 (2d Dist. 1984). Although public utilities may not be required to charge a rate that is so low it can be considered confiscatory and in violation of the United States Constitution, public utilities cannot charge customers more than what the services rendered are reasonably worth. *Island Lake Water Co. v. Ill. Commerce Comm’n*, 65 Ill. App. 3d 853, 857, 382 N.E.2d 835, 838, 22 Ill. Dec. 445 (2d Dist. 1978). Here, the 7.71% rate of return derived by the Staff financial analyst did not account for the water quality or any other measure of what the services rendered by Camelot are reasonably worth. (Tr. at 168, July 13, 2011). This profit level does not reflect a just and reasonable return and should be lowered by this Commission to a rate that is closer to the legal rate of interest.

This Commission has found that a utility's quality of service can be the basis for lower rates. In *Island Lake*, there was testimony of a customer stating that the water was bad, the pressure was bad, and the service was bad. 65 Ill. App. 3d at 859, 382 N.E.2d at 840. Petitions were signed by a number of customers who protested any rate increase. *Id.* The mayor of Island Lake argued at one of the hearings that the increase should be turned down because of substandard infrastructure. *Id.* This Commission found this evidence to be sufficient to reduce the rates, but the appellate court struck down the order, holding that the Commission had not made enough of a finding to show a relationship between the companies conduct and the substandard service. *Id.* This holding seems to imply that this Commission needs to find causation between the substandard service and utility management to support a finding that the proposed rates are unreasonable. *See Id.* Here, there is a substantial amount of evidence in the record to find substandard service, along with many statements that show Camelot's lack of due care and diligence.

This docket includes an extraordinary number of comments and prepared rebuttal testimony from consumers reflecting their concerns about substandard water quality. "We have paid for drinking water from Hinkley since we built our home in 1984 . . . We have never trusted the tap water for drinking, cooking, etc." Prepared Rebuttal Testimony of Barb Studer at 1. "We now buy bottled water to drink and to use for coffee. We only use tap water when it is boiled first." Prepared Rebuttal Testimony of Beth Stuchly at 1. "[O]ur water gets a sulfur smell in our washer, water pressure can be low, and if you leave water in a bowl, such as a pet bowl, the bowl gets brown on the bottom." Prepared Rebuttal Testimony of Linda Hawkinson at 1. "[O]ur 'white' clothing has a tendency to turn 'yellowish' despite trying several different brands of detergents." Prepared Rebuttal Testimony of Toni Tully at 1. One homeowner describes how,

countless times, she has refused to even give her dog water from her faucet because of the smell. Prepared Rebuttal Testimony of Bobbe Marion at 1. She also estimates that she spends \$150 annually on filters to make the water drinkable. *Id.* It is notable that, although Camelot only serves 200 customers in one subdivision, 19 households have prepared and filed direct testimony in this case discussing the poor water quality that is provided by the Utility. Fifty nine other customers filed public comments on e-docket expressing their displeasure with the increase, their negative perception of the quality of service, or the burden that this increase will place on their budgets.

The remarks made in Camelot's testimony show how Camelot perceives these complaints. The Regional Director of Operations, Bruce Haas, states that Camelot's goal is to provide customers with "adequate, efficient, reliable, environmentally safe and least-cost water." CUI Ex. 1.0 at 1. Notably missing from this statement is anything about quality standards beyond IEPA minimum standards, whether the water is suitable for drinking and cooking, any desire to compare performance to neighboring markets, or any measure of customer satisfaction.

The utility's inattention to service quality is similar to its inattention to other operating obligations. One homeowner's prepared rebuttal testimony chronicles the lack of diligence that the Camelot Utility has maintained in dealing with the Camelot Homeowners Association:

"We [the Camelot Homeowners] described to [our Utilities Inc. representative] how the peeling paint on the fascia of the building [that houses our water well] and the overgrown bushes had become an eyesore in our neighborhood. Although Utilities, Inc. trimmed the bushes and applied aluminum to half of the fascia of the building, it never repainted the fascia that faces the road, which is the most obvious to those who pass by."

Prepared Rebuttal Testimony of Beth Stuchly at 1.

The case here is different than the case in *Island Lake*. The *Island Lake* court implied that the Commission needs to find a lack of care or diligence on the part of the Company to support a finding that the substandard service should be reflected in the reasonable rate. Camelot homeowners testified that the service that they are being provided is substandard. Camelot's response has been half-hearted – it claims that it provides an adequate, efficient, low-cost service that meets IEPA standards. This is a company that provides minimum services to a small group of customers, who it is now asking to pay the highest rates in the State of Illinois for water that is not drinkable. These rates are unreasonable and this Commission should adjust them to reflect the services actually provided.

D. The Proposed Rates Should Be Rejected Because They Are Unreasonable and Would Constitute Rate Shock.

The Utilities propose that revenue and rates increase by more than 250% for Great Northern consumers, 175% for Camelot water, 71.87% for Camelot sewer customers, and 45.6% for Lake Holiday consumers. Staff Ex. 10.0, Sch. 10.01 GN, C-W Rev., C-S Rev, and LH Rev. As the Staff rate design witnesses all described:

Rate shock occurs when a customer purchasing a commodity, such as water, must pay a significantly higher amount for comparable service. While customers generally do not expect prices to remain unchanged forever, they also typically do not expect an abrupt and extreme change in prices that could cause them significant financial distress.

Staff Ex. 4.0 at 12; Staff Ex. 5.0 at 24; Staff Ex. 6.0 Rev. at 15.

Each Staff witness then concluded that the increases proposed by Staff witnesses in their direct testimony constituted rate shock. Staff Ex. 4.0 at 12; Staff Ex. 5.0 at 25-26; Staff Ex. 6.0 Rev. at 15-16. Yet, none of these witnesses suggested any way to mitigate or avoid rate shock.

The avoidance of “rate shock” is a well established regulatory principle and has guided this Commission in determining appropriate utility rates. *See, e.g., Citizens Utils. Bd. v. Ill. Commerce Comm’n*, 276 Ill. App. 3d 730, 738, 658 N.E.2d 1194, 1201 (1st Dist. 1995); *Camelot Utils., Inc. v. Ill. Commerce Comm’n*, 51 Ill. App. 3d 5, 10, 365 N.E.2d 312, 315 (3d. Dist. 1977). Before this Commission can order a rate increase, it must consider evidence which can support a finding that the new rates will impose just and reasonable burdens on all ratepayers. *Citizens Utils. Bd.*, 276 Ill. App. 3d at 738, 658 N.E.2d at 1201. The evidence in this docket shows how unjust and unreasonable the burden is that is being placed on ratepayers in Great Northern and Camelot areas, and to a lesser extent, in the Lake Holiday area.

At least one Illinois court has recently recognized that the concept of “rate shock” is a close relative to the doctrine of promissory estoppel. *Commonwealth Edison Co. v. Ill. Commerce Comm’n*, 398 Ill. App. 3d 510, 525-26, 924 N.E.2d 1065, 1083-84, 338 Ill. Dec. 539 (2d Dist. 2009). The doctrine of promissory estoppel is “an equitable device invoked to prevent a person from being injured by a change in position made in reasonable reliance on another's conduct.” *Kulins v. Malco, A Microdot Company, Inc.*, 121 Ill. App. 3d 520, 527, 459 N.E.2d 1038, 1045, 76 Ill. Dec. 903 (1st Dist. 1984). To invoke promissory estoppel, a claimant must show all of the following: (1) an unambiguous promise, (2) reasonable reliance on the promise, and (3) detriment resulting from reliance on the promise. *Commonwealth Edison Co.*, 398 Ill. App. 3d at 526, 924 N.E.2d at 1084.

The doctrine of promissory estoppel is an established legal principle on which to base the doctrine of rate shock in this docket. Illinois law imposes certain duties on regulated utilities; the most essential duty is to offer rates that are “just and reasonable.” 220 ILCS 5/9-101 (2011). That obligation is grounded in the ratemaking formula and the regulatory compact, requiring that

the utility will request rates that are necessary to cover its costs and to provide a fair and reasonable return to its investors. *See Peoples Gas Light & Coke Co. v. Slattery*, 373 Ill. 31, 54, 25 N.E.2d 482, 494 (1939); *see also Ill. Bell Telephone Co. v. Ill. Commerce Comm’n*, 414 Ill. 275, 289, 111 N.E.2d 329, 337 (1953). Because this obligation is so firmly grounded, consumers are entitled to rely on the regulatory compact, and thus are reasonable in expecting both that the rates will change gradually over time, and that the utility company will fulfill its obligation to assure that the gap between rates and costs does not become excessive. The Commission should not accept the shocking rate increases requested in this docket as credible, fair or lawful in light of the Utilities’ obligation to the public to only charge “just and reasonable” rates to avoid rate shock.

1. Rate cases are a statutory duty that a utility company owes to its customers.

Upon becoming the monopoly water and wastewater utility, the Utilities made an unambiguous promise to its Illinois customers, commonly referred to as a “regulatory compact”. The Company posits that rate cases are an elective procedure that the Utilities can undergo at their own will: “A utility not earning a fair rate of return may not seek a rate increase for a number of reasons.” GNUI/CUI/LHUC Ex. 3.0 at 11. However, the plain language of the Public Utilities Act demonstrates that rate cases are not a discretionary process -- they are a duty that utilities owe their customers and their investors.

The Illinois Public Utilities Act provides that utility “rates and other charges made, demanded or received by any product or commodity furnished or to be furnished or for any service rendered or to be rendered shall be just and reasonable.” 220 ILCS 5/9-101 (2010). Every utility company in Illinois has a specific *duty* to not perform service unless such service is

performed in accordance with the provisions of the Act. 220 ILCS 5/9-104 (2010). It is well settled that “just and reasonable” rates are rates which afford the utility the opportunity to cover prudently incurred costs and to provide a reasonable rate of return to its investors – rates which are too high and rates which are too low are not “just and reasonable” rates. *State Pub. Utils. Comm’n. ex rel. Springfield v. Springfield Gas & Elec. Co.*, 291 Ill. 209, 216-17, 125 N.E. 891, 895 (Ill. 1919). Colton summarized this duty in stating, “So long as the utility does not seek a rate increase, it is to be conclusively presumed that the opportunity to earn a reasonable rate of return was sufficient.” AG Ex. at 14. The Utilities made an unambiguous promise to their customers that they would maintain rates that are just and reasonable for the services provided.

For over a decade the Utilities ignored their duty to their customers to seek reasonable rates, cut their costs, or stop providing service. The utilities use the length of time since their last rate case to justify the extraordinarily large increases they seek in this docket. In direct testimony, the Company states: “Rates granted in 1993 (1992 test year) [or 1998 , as the case may be] do not reflect the *18 years* [*13 years*] of rising costs” GNUI Ex. 1.0 at 2; LHUC Ex. 1.0 at 2; CUI Ex. 1.0 at 2 (emphasis added). The Staff witnesses similarly refer to the utilities’ reference to the length of time since their last rate case as justification of the huge increases and rate shock resulting from the utilities’ requested increases. Staff Ex. 4.0 at 12-13; Staff Ex. 5.0 at 25-26; Staff Ex. 6.0 Rev. at 15-16. The length of time between rate cases is wholly within the Utilities’ control, and consumers should not be unreasonably burdened if the Company did not see the need to increase revenues for several years.

Further, the Company’s annual reports filed with the Commission show that in fact the net income (loss) were uneven and stochastic. For example, the Camelot utility reported losses of \$34,703 in 2006 and \$31,333 in 2009, but reported gains of \$9,508 in 2007 and \$28,408 in

2008. AG Cross Ex. 6; *see also* Table 2 on page 4, *supra*. The other utilities' net income was also variable: Great Northern reported losses between \$8,680 and \$49,308 from 2006 to 2009, and Lake Holiday, after reporting \$54,628 in gains in 2006, reported losses between \$11,637 and \$107,882 from 2007 to 2009. *Id.* If these random bouts of gains and losses were essentially the function of the Company's "rising costs," then the Utilities had a duty long ago to seek rate increases. Rather than simply accepting the utilities' claims that they need to double or almost triple rates, the Commission should question the credibility of the Utilities and ask how the utilities operated since 2006 at half of their required revenue level while investing hundreds of thousands of dollars.

2. The Utilities' consumers reasonably and detrimentally relied on the Utilities to perform their duty to charge only just and reasonable rates.

Consumers have the right to rely on the regulatory promise made by a utility company to charge just and reasonable rates and to adjust those rates gradually, and as needed to cover their costs. Colton correctly states that "rates that have been subject to prior regulatory approval are conclusively presumed to be reasonable until they are modified in a subsequent rate order." AG Ex. 1.0 at 14. Consumers budget for their utility bills under the assumption that each year's rates, supposedly being just and reasonable, would be approximately the same from year-to-year. (*See e.g.*, Pamela Parenty comment filed under Docket No. 11-0141, *and see* Steve Ayers comment filed under Docket No. 11-0059). Consumers purchase houses in the areas served by the utilities believing that the utility rates currently being charged somewhat accurately reflect the expenses that will be incurred in future years. (*See* Prepared Direct Testimony of Suzane Basak at 2). Consumers are justified in expecting that they would not be blindsided by doubled or tripled utility rates in a single year.

Consumers have a right to rely on the regulatory process because utility companies have a self interest in setting rates at levels that cover their costs. Companies owe a duty to their shareholders to maximize profits. It is the responsibility of the shareholders, officers, and directors of a company to ensure that the company seeks to increase rates when revenues no longer cover costs.

Consumers cannot be expected to, and are not responsible for, policing the company to ensure that it is covering its costs. Utility consumers have the right to rely on the utilities' right and obligation to seek to increase rates if revenues fail to cover utility costs. Here, it is apparent that either the Company failed to seek adequate rates when the rates being charged no longer covered operating costs, or the requested increases are over-stated. The shareholders, officers, and directors who failed to seek increased revenues should bear the burden of this failure to gradually address rising costs -- not the customers.

The *Commonwealth Edison* case discusses promissory estoppel in the context of a utility company's change to an "incentive" rate for non-residential customers. There, business customers complained that the utility should be prevented from removing an incentive program because "after decades of buildings being constructed in reliance on the separate rate treatment provided under [the program], it would be prohibitively expensive for buildings to switch to energy sources other than electricity for heating." *Commonwealth Edison*, 398 Ill.App.3d at 525-26, 924 N.E.2d at 1083-84. The appellate court read this as an argument for the application of promissory estoppel, but held that the doctrine did not apply because it was not reasonable for the business customers to expect that an *incentive* program would continue indefinitely. *Id.*

Consumer reliance in this case is much different than the reliance in *Commonwealth Edison*. Here, the customers reasonably relied on the fact that the utilities had not sought to

increase their rates over the last several years, and they had no reason to believe that they were paying rates that could suddenly more than double, rising to a level equivalent to the highest rates reported by the Commission and in the Carbondale rate survey. AG Ex. 1.0 at 9-10. In *Commonwealth Edison*, there was no law requiring the company to maintain the incentive rate; the rate existed at the discretion of the company. By contrast, in this docket, basic water and sewer rates are at issue, and these non-discretionary rates for essential, monopoly services are governed by the regulatory compact between consumers and the Utilities. While it may not be reasonable, under *Commonwealth Edison*, to rely on a company to indefinitely continue a publicly acknowledged incentive program, *it is reasonable* for consumers to rely on the Utilities to perform a statutory duty to only charge rates that are just and reasonable and to change rates gradually as necessary to cover the cost of service. Here, unlike *Commonwealth Edison*, the customers' reliance on the Company to consistently seek just and reasonable rates was reasonable.

Consumers' reliance on the Utilities' promise also includes reliance on the Commission to assure that rates are changed gradually and that consumers will not be faced with rate shock due to a utility's failure to reasonably manage its operations. This Commission should limit the Utilities' rate increase request to remove unjustified rate base investment, to reverse the increase in allocations from the WSC proposed by Staff, and to reduce the return on equity and return on rate base to preserve rate continuity, understandability, and public acceptance. See 220 ILCS 5/1-102(d). Justice requires that this Commission reject the revenue levels and rates contained in the revised Joint Stipulation and instruct the company to seek substantially lower rates.

III. CONCLUSION

The People respectfully request that the Commission enter an order consistent with the recommendations contained in this Initial Brief for Great Northern Utilities, Inc, Camelot Utilities, Inc. and Lake Holiday Utilities Corporation.

Respectfully Submitted,

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